

C O N F I D E N T I A L SECTION 01 OF 02 TEL AVIV 002271

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TAGS: [ECON](#) [EFIN](#) [ETRD](#) [ELAB](#) [PREL](#) [IS](#) [ECONOMY](#) [AND](#) [FINANCE](#)

SUBJECT: BIBI BULLISH ON ISRAELI ECONOMY TO CODEL ISSA

Classified By: DCM Richard LeBaron, per 1.4(b) and (d).

11. (C) Summary: An ebullient Binyamin Netanyahu told CODEL Issa April 14 that Israel's economy is continuing to improve now that reforms are beginning to take effect. Netanyahu's "success" in battling the unions, GDP growing at 3 percent this year, pension reform, and lower taxes are all contributing factors. The GOI intends to keep its focus on reducing the deficit and to invest in infrastructure, including the completion of the Trans-Israel Highway, as well as a rail system to connect Ashdod port with the Red Sea port of Eilat. It further intends to reduce the number of foreign workers in Israel to lower the unemployment rate among Israelis and thus reduce state expenditure on welfare benefits. CODEL Issa raised concerns about U.S. companies being shut out of competition on the natural gas pipeline network and cellular phone contracts, both of which Netanyahu promised to look into. A Bank of Israel official was also upbeat on the direction of the Israeli economy, but cautioned that the GOI still had some way to go in its reforms. End Summary.

12. (C) An energized Binyamin Netanyahu told Congressman Darrell Issa and House International Relations Committee staff member Hillel Weinberg April 14 that the Israeli economy is moving in the right direction under his guidance at the Ministry of Finance. Charge d'Affaires Richard LeBaron also attended. Opening the meeting, Netanyahu said that in his two-year tenure to date union wages had been lowered, the government's work force reduced by 2 percent, the VAT lowered to 17 percent from 18 percent, and the income tax reduced as well. The economy is currently growing by 3 percent and the stock market has risen by 100 percent since last year, he added. Crowing over his victory against the unions, Netanyahu described how he had wrested control of the pension system from the unions and raised the retirement age from 65 to 67 in order to pay for necessary restructuring and to balance the books. The next and last step is to privatize the union pension system and the state-owned banks. Netanyahu said that he intends to decrease the number of foreign workers in Israel in order to reduce the number of Israelis living off of the state's welfare benefits. This would, in turn, contribute to a lowering of state expenditures. Although many of his reforms are unpopular (as demonstrated by the number of strikes Israel has weathered), Netanyahu said that he had taken a lesson from U.S. Federal Reserve Chairman Alan Greenspan who applies two questions to evaluate the health of an economy to gauge the health of the Israeli economy. First, is the stock market rising? The answer, he said, clearly is "yes." Second, are the rates for long-term bonds falling? Again, Netanyahu reported the answer in Israel was a resounding "yes." Saying his main report card is the behavior of the markets, Netanyahu clearly thought he had scored well.

Investing in Infrastructure

13. (C) Netanyahu announced that the GOI intends to construct a rail line as a land bridge to connect the Red Sea port of Eilat with the Mediterranean port of Ashdod, the goal being to develop a route to compete with the Suez Canal. Goods would move by rail to Ashdod and then by ship across the Mediterranean. Netanyahu pointed out that almost two thirds of all shipping containers currently return to Europe from Israel empty; the new rail line would make filling the containers easier, in particular facilitating the movement of Dead Sea minerals to the coast for export. Netanyahu also said that the GOI is investing in the completion of the north-south Trans-Israel Highway, which will assist in opening up the southern regions of Israel, in particular the Negev. With regard to the purchase of natural gas from Egypt, Netanyahu said that he wants competition for all gas suppliers, including the Egyptians, British Gas, and the Israeli-American supplier.

"Level the Playing Field for U.S. Business"

14. (C) Congressman Issa congratulated Netanyahu on all of the reforms that have been implemented during his tenure at the ministry, but noted that the VAT, even at the new rate of 17 percent, remains high. Netanyahu agreed, adding that he

hopes the rate will go even lower in the future. Turning to the development of a domestic pipeline for gas distribution, Congressman Issa stressed that by hiring a Dutch firm to design the pipeline, Israel appears to have committed to using Dutch specifications for the pipeline's construction -- a situation that clearly cuts out American firms from the process, despite the fact that U.S. technology is the world standard. Netanyahu agreed, seemingly surprised by the news.

He said he would look into the matter.

15. (C) Moving on to cellular communication, Congressman Issa said that the United States wants only a level playing field for U.S. companies to enter the market. For example, Qualcomm is a world leader in CDMA (code division multiple access) or fixed wireless technology, but not on the GSM system standard used in Europe and in some countries of the Middle East. In Saudi Arabia, the SAG had held an open bid for the cellphone system, but only on the GSM system, leaving no room for CDMA despite CDMA's far lower cost for domestic users and an area where U.S. firms such as Qualcomm excel. Issa asked that Israel leave room for both technologies to develop and let the markets themselves decide which will predominate. Netanyahu said that Israel intends to privatize Bezeq (the Israeli telephone service) and he promised to examine the possibilities of taking the two-system approach advocated by the Congressman.

Israel Bank Also Upbeat

16. (C) Karnit Flug, head of research at the Bank of Israel, was somewhat less ebullient than the FinMin, but still upbeat in her April 14 discussion with HIRC staff member Hillel Weinberg. Flug said that while there had been an initial dip in the Israeli economy in 2001, it is difficult to determine how much of that could be related to the Intifada and how much to the poor state of the world economy at that time. The effects of the Intifada were initially felt in areas such as tourism, but those effects gradually spread to other parts of the economy as investors realized that the uncertainty connected with the Intifada was going to be a longer term phenomenon.

17. (C) Flug reported that the spike in unemployment in year 2000 had leveled out in 2003, with the export sector clearly leading the recovery. The GOI is serious in its efforts to limit the number of foreign workers in Israel, the number of whom almost matches the current rate of unemployment. Flug disputed the conventional wisdom that foreign workers take jobs that Israeli citizens would not. As an example, she cited the approximately 35,000 Israeli Arabs who had been employed in the construction industry up until the mid-1990's. Now, because foreign labor is so inexpensive, virtually all of the positions are now held by foreign workers.

18. (C) Calling the current government's fiscal policy "more responsible and determined," Flug gave FinMin Netanyahu high marks on his willingness to take tough measures to reduce the deficit (Note: the goal for 2004 is 4 percent. End note). That, in turn, allowed the Bank to ease interest rates. She cautioned, however, that the GOI still has a long way to go to reduce the size and cost of government expenditures.

19. (U) CODEL Issa did not have an opportunity to clear this message.

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